

ST 01-26

Tax Type: Sales Tax

Issue: Books and Records Insufficient

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**ABC'S RESTAURANT, INC.,
Taxpayer**

Docket No. 00-ST-0000
IBT # 0000-0900
NTL # 00 0000000000000000
Period 7/1/95 - 12/31/98

**Ted Sherrod
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General Marc Muchin on behalf of the Illinois Department of Revenue; Kenneth Rosenberg, Esq. of Dordek, Rosenberg & Associates, on behalf of ABC's Restaurant, Inc.

Synopsis:

This matter is before this administrative tribunal pursuant to a timely filed protest of Notice of Tax Liability no. 00 0000000000000000 for the audit period 7/1/95 to 12/31/98 issued to ABC's Restaurant, Inc. (hereinafter referred to as "taxpayer") by the Department of Revenue ("Department") on June 30, 1999. A pre-trial order was entered on March 13, 2001 in which the parties stated the issue to be decided as "(W)hether Taxpayer can provide sufficient documentation to support its contention that the

Department overstated Taxpayer's gross receipts for the audit period July 1, 1995 through December 31, 1998". A hearing on this matter was held on June 28, 2001. Following the submission of evidence and a review of the record, it is recommended that this matter be resolved in favor of the Department. In support of this recommendation, I make the following findings of fact and conclusions of law.

Findings of Fact:

1. The Department's *prima facie* case against the taxpayer inclusive of all jurisdictional elements was established by the admission into evidence of the SC-10-K Audit Correction and/or Determination of Tax Due ("correction of return") and the Notice of Tax Liability ("NTL") showing a proposed tax liability, penalty and interest in the amount of \$93,122 for the audit period 7/1/95 to 12/31/98. Dept. Ex. 1, 2.¹
2. The taxpayer, an Illinois corporation, is engaged in the operation of a Mexican restaurant located at Anywhere, Illinois and a nearby nightclub located at Anywhere, Illinois, and in the sale of food and liquor at these establishments. Tr. pp. 25, 80, 121; Dept. Group Ex. 3.
3. Jane Doe is the President of the taxpayer. Dept. Group Ex. 3.
4. The Department conducted an audit of the taxpayer's business operations for the period beginning 7/1/95 through and including 12/31/98. Dept. Ex. 1, 2; Dept. Group Ex. 3.
5. During the audit, the Department's auditor obtained supplier information showing the cost of certain items of food and liquor the taxpayer purchased for subsequent sale at retail by the taxpayer during the period in controversy; this information was received

¹ Unless otherwise noted, findings of fact apply to the audit period.

in the form of completed form EDA 20s. Tr. pp. 13, 15, 16, 17, 18, 20, 21, 22, 23, 83, 92, 93, 94.

6. Wholesale suppliers to whom EDA 20s were sent for completion were identified by Jane Doe and by deliveries observed by the auditor; the auditor requested information from at least nine suppliers, and four suppliers returned completed EDA 20s. Tr. pp. 83, 118; Dept. Group Ex. 3.
7. EDA 20s were returned by ABC Beverage, XYZ Meat Supply Co., MMM Distributors and XX & ZZ, Ltd. Dept. Group Ex. 3.
8. The EDA 20s, including one received from XYZ Meat Supply Co., were used in determining purchases from which the auditor extrapolated a deficiency for underreported sales. Tr. pp. 17, 19, 20, 22, 23, 74, 75, 94; Dept. Group Ex. 3.
9. The state registration number indicated on the EDA 20 from XYZ Meat Supply Co. was not the correct registration number for this company. Tr. pp. 16, 17, 39, 40, 57, 58, 64.
10. The taxpayer notified the Department that the registration number for XYZ Meat Supply Co. on the EDA 20 it submitted was incorrect; the Department indicated that the registration number contained in the EDA 20 for XYZ Meat Supply Co. was not assigned to any company. Tr. pp. 17, 65.
11. XYZ Meat Supply Co. was the only non-liquor supplier surveyed by the auditor that returned a completed EDA 20. Tr. p. 73.
12. The EDA 20 from XYZ Meat Supply Co. reported over 90% of the total purchases reported on EDA 20s from the taxpayer's suppliers used by the auditor to extrapolate the taxpayer's gross receipts; had the EDA 20 received from XYZ Meat Supply Co.

been excluded, the auditor's estimate of underreported sales would have changed. Tr. pp. 23, 75, 118, 119.

13. The Department determined the taxpayer's 1996 and 1997 retailers' occupation tax liability for underreported sales by: i) extrapolating total purchases from the completed EDA 20s from four of the taxpayer's suppliers; ii) applying a mark up figure taken from the taxpayer's federal income tax returns; iii) reducing this amount to taxable receipts and iv) applying the retailers' occupation tax rate to this figure; the Department made a projection of the taxpayer's liability for July through December, 1995 and for 1998 based on this determination. Tr. pp. 13, 19, 20, 94, 95; Dept. Group Ex. 3.
14. The Department used this method to extrapolate the taxpayer's gross receipts because information provided by the taxpayer was insufficient; the information used by the Department was the best information available. Tr. pp. 27, 28, 81, 82, 88, 89.
15. The auditor determined that the taxpayer's gross receipts reported on its federal income tax returns were understated; this finding was based on a comparison of purchases shown by the auditor's survey of suppliers to purchases reported on the taxpayer's federal income tax returns for 1996 and 1997. Tr. pp. 94, 95.
16. The auditor attempted to determine the taxpayer's liability by comparing cash receipts to bank deposits but was unable to do so because not all of the taxpayer's bank statements were available at the time of the audit, and because there was nothing to substantiate the excess cash claimed to be used for cash purchases. Tr. pp. 14, 15.

17. The taxpayer failed to produce any cash register receipts, purchase invoices, sales invoices, sales receipts, bank statements or any other books and records during the audit. Tr. pp. 7, 8, 81, 82.
18. The taxpayer did not maintain cash register receipts providing a daily record of the gross amount of sales as required by 86 Ill. Admin. Code, section 130.805. Tr. p. 82.
19. Some of the taxpayer's records were lost in a flood. Tr. pp. 8, 9, 68, 69, 81, 82, 112, 116, 142; Dept. Group Ex. 3.
20. Mr. Joe Blow is a certified public accountant retained by the taxpayer to review the Department's deficiency and determine whether there is any basis for the taxpayer to receive an assessment adjustment. Tr. pp. 29, 51.
21. Mr. Blow attempted to determine the taxpayer's correct liability by comparing gross sales shown on the taxpayer's monthly sales tax returns with bank deposits into the taxpayer's bank account at First Bank during 1995, 1996, 1997 and 1998; he determined that total sales reported for this period were \$644,546, while total deposits were \$444,148. Tr. pp. 44, 45, 66, 67; Taxpayer's Ex. 2.
22. Mr. Blow attributed the discrepancy between gross sales and total deposits to cash payments made by the taxpayer to its liquor suppliers; however, this finding was not supported by any documentation given the auditor. Tr. pp. 67, 68.
23. The bank statements used by Mr. Blow were incomplete; there were no statements for 1995 and 1996. Tr. pp. 47, 48.
24. Mr. Blow concluded that the underreported sales shown in the auditor's report were overstated based on his comparison of gross sales shown on the taxpayer's sales tax returns with deposits into the taxpayer's bank account at First Bank. Tr. pp. 51, 52.

25. The taxpayer was assessed a negligence penalty and a late payment penalty. Tr. pp. 8, 96.

Conclusions of Law:

Pursuant to 35 ILCS 120/4, the correction of returns submitted as the Department's exhibit 2 is prima facie correct and constitutes prima facie evidence of the correctness of the amount of tax due as shown thereon. Once the Department establishes the prima facie correctness of the amount of tax due through the admission into evidence of the correction of returns, the burden shifts to the taxpayer to show that this determination is incorrect. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826 (1st Dist. 1988). On examination of the record in this case, I conclude that the taxpayer has not presented sufficient evidence to overcome the Department's prima facie case. Accordingly, for the reasons given below, the aforementioned NTL should be affirmed in its entirety.

The Retailers' Occupation Tax Act, 35 ILCS 120/1 et seq., has a specific requirement for maintaining books and records, which provides as follows:

Every person engaged in the business of selling tangible personal property at retail in this State shall keep records and books of all sales of tangible personal property, together with invoices, bills of lading, sales records, copies of bills of sale, inventories prepared as of December 31 of each year or otherwise annually as has been the custom in the specific trade and other pertinent papers and documents.
35 ILCS 120/7.

The taxpayer's duty to keep such books and records is mandatory. Smith v. Department of Revenue, 143 Ill. App. 3d 607 (5th Dist. 1986). If the taxpayer does not have adequate books and records to support its monthly tax returns, the Department is justified in going

outside of the taxpayer's books and records to obtain information to correct the taxpayer's returns. Young v. Hulman, 39 Ill. 2d 219 (1968). The record in this case clearly shows that the taxpayer did not produce books and records to substantiate gross sales reported on its sales tax returns. Tr. pp. 81, 82.

The Department determined that the taxpayer underreported its taxable gross sales when, after reviewing sales records supplied by the taxpayer's suppliers, it was discovered that the wholesale purchases from only 4 of 9 suppliers greatly exceeded the cost of goods sold shown on its federal income tax returns. Tr. pp. 13, 94; Dept. Group Ex. 3. Accordingly, the Department developed a mark up factor from the taxpayer's federal income tax returns and applied this factor to the taxpayer's aggregate wholesale purchases as reported on the EDA 20 reports the Department received from the taxpayer's suppliers. Tr. pp. 13, 19, 20, 94, 95; Dept. Group Ex. 3.² The corrected return prepared using this analysis indicated that the taxpayer's actual gross receipts exceeded gross receipts reported by the taxpayer. Dept. Ex. 2.

The Department is not required to substantiate the basis for its corrected return in this case. See A.R. Barnes & Co., *supra*. Accordingly, proof that its audit determination meets a minimal standard of reasonableness through testimony of the auditor explaining the calculations at the hearing is not required unless a taxpayer has introduced evidence sufficient to rebut the Department's prima facie case. A.R. Barnes & Co., *supra*. Hence, the threshold issue in this case is whether the taxpayer has presented evidence or testimony sufficient to overcome the presumed correctness of the Department's mark-up calculation used to arrive at the taxpayer's gross sales.

To overcome the Department's prima facie case, the taxpayer must present consistent, probable evidence closely identified with its books and records. Copilevitz v. Department of Revenue, 41 Ill. 2d 154 (1968); Central Furniture Mart v. Johnson, 157 Ill. App. 3d 907 (1st Dist. 1987); Vitale v. Department of Revenue, 118 Ill. App. 3d 210 (3d Dist. 1983); A.R. Barnes & Co., *supra*. The taxpayer attempts to meet this burden by disputing the accuracy of the supplier reports the Department used as a basis for calculating the taxpayer's purchases. Tr. pp. 142, 143, 144, 145, 146. The record shows that over 90% of the total purchases used by the auditor to extrapolate the taxpayer's gross receipts were purchases reported by XYZ Meat Supply Co. on its EDA 20 reporting sales to the taxpayer during the audit period in controversy. Tr. pp. 75, 118, 119. The taxpayer contends that this information should not have been used because the registration number contained in the XYZ Meat Supply Co. response to the Department's request for sales information was incorrect. Tr. pp. 144, 145, 146.

The EDA 20 received from XYZ Meat Supply Co. reporting sales made to the taxpayer indicates the taxpayer's name, address, registration number and customer number. The customer number is the number assigned by XYZ Meat Supply Co. to its customer, ABC's Restaurant. Tr. p. 24. The address for ABC's Restaurant shown on this form matches the address for this company in other documents contained in the record including a Statute of Limitations Waiver which is signed by the taxpayer's President, Jane Doe. Dept. Group Ex. 3. This address is clearly the taxpayer's correct address. Moreover, the record contains unchallenged and unrebutted testimony that the customer number for ABC's Restaurant shown on the EDA 20 from XYZ Meat Supply Co.

² Although the auditor, during his direct examination and cross examination, testified that he used only 3 of the EDA 20s, a review of his Schedule D detailing the EDA 20s that were used shows that he used all 4

matched the customer number used by this company to identify the taxpayer. Tr. pp. 25, 26. In sum, while the registration number shown for ABC's Restaurant in the EDA 20 prepared by XYZ Meat Supply was incorrect, all other indicia identifying the taxpayer contained in this form were correct. Furthermore, the taxpayer has presented no invoices or other information regarding its purchases that the auditor might have used in lieu of the EDA 20 he received from XYZ Meat Supply Co. to establish the amount of purchases the taxpayer made from this company. Consequently, the EDA 20 from XYZ Meat Supply Co., in spite of the erroneous registration number for the taxpayer it contained, was clearly the best information available to the auditor regarding the taxpayer's purchases. Given these facts, it was not unreasonable for the auditor to rely on the EDA 20 from the XYZ Meat Supply Co. as a basis for making his findings.

Moreover, a taxpayer cannot overcome the Department's prima facie case merely by denying the accuracy of the Department's assessment, offering alternative hypotheses or arguing that its audit methodology is flawed. A.R. Barnes & Co., supra; Central Furniture Mart, supra; Quincy Trading Post, Inc. v. Dept. of Revenue, 12 Ill. App. 3d 725 (4th Dist. 1973). Simply questioning the Department's assessment or denying its accuracy is not enough. Quincy Trading Post, supra. A taxpayer can overcome the Department's prima facie case only by producing competent evidence identified with the taxpayer's books and records. Vitale at 213.

The taxpayer also contends that critical records needed to rebut the Department's prima facie case were destroyed in a flood and argues that the taxpayer should not be fatally prejudiced by events beyond its control. Tr. p. 142. The taxpayer's claim that some of its records were destroyed in a flood is corroborated by documents contained in

of the EDA 20s he received. Dept. Group Ex. 3.

the record. Tr. p. 112; Dept. Group. Ex. 3. However, the record also indicates that this damage occurred on July 16, 1997. Dept. Group Ex. 3. Consequently, the flood that took place does not explain why the taxpayer could not produce records for the portion of the audit period after this date. Moreover, the record contains credible and un rebutted testimony that the taxpayer never generated cash register tapes or sales journals or ledgers that would have been prepared from these tapes needed to conclusively rebut the Department's findings. Tr. p. 82; Dept. Group Ex. 3. Since these records were never created, the records that were destroyed by the flood could not have contained them. Therefore, even if the records destroyed by the flood had not been lost, the taxpayer would not have been able to produce essential records necessary to rebut the Department's prima facie case.

The taxpayer also attempts to rebut the Department's prima facie case by introducing into the record a "sales and cash receipts analysis" report prepared by Joe Blow, the taxpayer's accountant. Tr. pp. 52, 53; Taxpayer's Ex. 2. This report is based on a comparison of the gross sales reported on the taxpayer's sales tax returns to deposits into the taxpayer's bank account at First Bank, a local bank. Tr. pp. 44, 45, 66, 67, 68, 69; Taxpayer's Ex. 2. The Department's auditor testified that he also attempted to determine the taxpayer's gross receipts in this manner but could not do so because the taxpayer's bank deposit records were incomplete. Tr. pp. 14, 15. Moreover, the auditor found that there were no records to substantiate the taxpayer's alleged use of receipts that were not deposited to make cash purchases. Tr. pp. 14, 15.

Mr. Blow admitted that the taxpayer's bank records were incomplete. Tr. pp. 47, 48. Moreover, none of the bank records purportedly relied upon by Mr. Blow were

introduced into the record at the hearing. Mr. Blow also testified that he relied on receipts from suppliers that the auditor was not shown to substantiate his conclusion that amounts not deposited into the bank were used to make cash purchases. Tr. pp. 67, 68. However, none of these records were produced at the evidentiary hearing.

Testimony alone cannot rebut the Department's prima facie case unless it is corroborated or identified with reference to the taxpayer's books and records. Copilevitz v. Department of Revenue, *supra*; Soho Club, Inc. v. Department of Revenue, 269 Ill. App. 3d 220, 229 (1st Dist. 1995); A.R. Barnes & Co. at 833, 834. In the instant case, the taxpayer has presented no such evidence to show that the Department's determination was arbitrary, capricious or unreasonable. Moreover, case law in Illinois clearly indicates that merely denying the accuracy of the Department's assessments, offering alternative hypotheses or arguing that its audit methodology is flawed is not enough to overcome the Department's prima facie case. A.R. Barnes & Co., *supra*; Central Furniture Mart, *supra*; Quincy Trading Post Inc., *supra*. Consequently the sales and cash receipts analysis report presented by Mr. Blow, which has not been substantiated by the admission of any evidence identified with books or records, is simply not sufficient to meet the taxpayer's burden in this case. Mel Park Drugs v. Department of Revenue, 218 Ill. App. 3d 203 (1st Dist. 1991).

The cover letter accompanying Mr. Blow's report indicates that the report was mailed on October 13, 2000, which was after the commencement of administrative review of the Department's NTL by this tribunal, and that it was sent to the attorney representing the taxpayer in these proceedings. Taxpayer's Ex. 3. These facts indicate that this document was prepared in anticipation of possible litigation in this matter.

Records prepared in anticipation of litigation are not records made in the ordinary course of business and are not admissible into evidence unless they fall within an exception to the hearsay rule. In re A.B., 308 Ill. App. 3d 227 (2d Dist. 1999). However, the Department did not object to the admission of this exhibit.

Hearsay evidence that is admitted without objection may be considered in an administrative proceeding. Jackson v. Board of Review of Department of Labor, 105 Ill. 2d 501 (1985). However, the weight to be given such evidence is completely within the discretion of the hearing officer. *Id.* As previously noted, there is nothing in the record to substantiate Mr. Blow' estimate of the taxpayer's gross sales except his testimony which was not be corroborated by any documents identified with the taxpayer's books and records admitted into evidence at the hearing. Consequently, I give Mr. Blow' report no more weight than the testimony and assertions upon which it is based. See Manion v. Brant Oil Co., 85 Ill. App. 2d 129, 136 (4th Dist. 1967) ("It is said that 'naked opinion' unsupported by reason is entitled to little weight and that the weight and value of evidence expressed through opinions largely depends upon the foundations of fact and reason upon which such opinions stand"), Mullen v. General Motors Corp., 32 Ill. App. 3d 122 (1st Dist. 1975), St. Paul Fire & Marine Ins. Co. v. Michelin Tire Corp., 12 Ill. App. 3d 165 (1st Dist. 1973). As noted previously, oral assertions alone are not enough to rebut the Department's prima facie case. Mel-Park Drugs, Inc., *supra*. Only consistent, probable evidence closely identified with books and records accomplishes this. A.R. Barnes & Co., *supra*; Vitale, *supra*; Copilevitz, *supra*; Central Furniture Mart, *supra*. Because Mr. Blow' report is not corroborated in any way by evidence identified with the

taxpayer's books and records that has been admitted into evidence, I find that this report is not sufficient to rebut the Department's prima facie case.

WHEREFORE, for the above stated reasons, it is my recommendation that NTL 00 0000000000000000 for the periods 7/1/95 to 12/31/98 be affirmed in its entirety.

Ted Sherrod
Administrative Law Judge

Date: September 19, 2000